

State of New York
Office of the State Comptroller
Division of Management Audit
and State Financial Services

**NEW YORK STATE RACING &
WAGERING BOARD**

**OVERSIGHT OF REGIONAL
OFF-TRACK BETTING OPERATIONS**

REPORT 98-S-13



H. Carl McCall
Comptroller



State of New York Office of the State Comptroller

Division of Management Audit and State Financial Services

Report 98-S-13

Mr. Michael J. Hoblock, Jr.
Chairman
New York State Racing & Wagering Board
1 Watervliet Avenue Extension
Albany, NY 12206-1668

Dear Mr. Hoblock:

The following is our report on our audit of the New York State Racing and Wagering Board's oversight of regional Off-Track Betting operations.

This audit was performed pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law. We list major contributors to this report in Appendix A.

*Office of the State Comptroller
Division of Management Audit
and State Financial Services*

April 5, 1999

Executive Summary

New York State Racing & Wagering Board Oversight of Regional Off-Track Betting Operations

Scope of Audit

The New York State Racing and Wagering Board (SRWB) regulates all horse racing activities in New York State, including the off-track pari-mutuel betting (OTB) operations. Six of SRWB's seven administrative regions have exercised their right to create an OTB corporation. Each regional OTB corporation has a board of directors who are responsible for its respective operations. SRWB reports show that, for the 1997 calendar year, about \$1.835 billion in bets were made at the six regional OTB corporations (corporations), which also had about \$15 million in other revenues. About \$1.4 billion was paid to winning bettors in the same year. Of the remaining \$450 million, about \$80 million was paid to local governments, \$135 million was paid to State race tracks, \$14 million was paid to the breeders' funds, and \$20 million was paid to the State Treasury. The corporations had aggregate operating expenses of nearly \$200 million.

For the 1998 State fiscal year, the SRWB had a total State-appropriated operating budget of \$14.7 million and employed 123 staff. Twelve of these employees spend some or all of their time on activities related to overseeing OTB operations. We audited the SRWB's efforts to oversee the operations of the Capital, Catskill, Nassau, New York City, Suffolk, and Western OTB corporations for the period of January 1, 1995 through June 30, 1998, and addressed the following questions:

- Does the SRWB provide adequate monitoring of revenue-generating OTB activities?
- Does the SRWB give effective guidance to the governing boards of the regional OTB corporations, ensuring that they fulfill their responsibilities?

Audit Observations and Conclusions

We concluded that the SRWB had provided little monitoring for the regional OTB corporations until 1997, but has since increased its oversight activities. We commend the SRWB for its increased efforts at monitoring and overseeing the regional OTB corporations and offer suggestions for further improving the SRWB's effectiveness.

We found that it is difficult to compare the corporations' financial operations because, although they each use a uniform chart of accounts, they do not all compile and report financial information in a consistent manner. Even the corporations' audited financial statements are not prepared or reported in comparable formats. To improve public

accountability, the SRWB should require the corporations to present their financial information in a standardized, consistent, and comparable format. (See pp. 5-7)

Although it had the authority, the SRWB did not routinely audit or investigate activities at the corporations until late 1997. The SRWB had also not actively reviewed the corporations' financial reports until the beginning of 1998. In the interim, some of the corporations developed serious financial problems. For example, the Capital OTB incurred operating losses for four consecutive years (1993 through 1996), contrary to its mission of generating revenue for the racing industry and State and local governments. A lack of expenditure control by Capital's board of directors had resulted in questionable expenses for such items as compensation packages for top staff, vehicle usage, travel and entertainment, and advertising and promotion. Although the corporations are routinely audited by OSC (which had previously identified some of Capital's fiscal problems), the SRWB had not utilized these audits as a monitoring tool until early in 1998. We encourage the SRWB to continue to identify issues to be audited and investigated at the corporations and to ensure that the resulting SRWB recommendations, as well as any OSC audit recommendations, are implemented. (See pp. 7-9)

Our examination of corporate governance found that some boards of directors, such as the boards of the New York City and the Western OTB corporations, have been more effective than others. The Catskill and Nassau OTB boards of directors have not established performance guidelines for their corporate officers; thus there are no measurable expectations to be evaluated. The SRWB should help these boards develop such guidelines. We also found that neither the Catskill OTB, the Nassau OTB, nor the Suffolk OTB prepares formal annual budgets or conducts regular reviews of its policies and procedures. Also, the internal auditors at the Catskill, Nassau, and Capital OTBs do not report directly to their respective boards, limiting their effectiveness. Moreover, neither the Catskill OTB nor the Suffolk OTB has periodically solicited competitive proposals for their external audit services. In addition, we found that two of the Catskill OTB board members did not attend any of the board's scheduled meetings during 1996 and 1997, and others attended very few meetings. We believe SRWB should encourage appointing authorities to replace inactive board members. (See pp. 9-22)

Comments of SRWB Officials

SRWB officials agree with many of the report's recommendations and indicate they have taken steps to implement them. Regarding corporate governance issues, SRWB officials state that, while some of the audit observations affect the SRWB, most require correction by the regional OTB corporations.

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Major Contributors to This Report	
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Introduction

Background

In 1970 and 1973, the New York State Legislature enacted Article V and Article VI, respectively, of the New York State Racing, Pari-Mutuel Wagering and Breeding Law (Law). This legislation allows local governments to operate systems of off-track pari-mutuel betting (OTB) as a method of raising revenue for the local governments, the racing industry, and New York State. The Law was also intended to prevent and curb unlawful bookmaking and illegal wagering on horse races, and to ensure that OTB activities are conducted in a manner compatible with the well-being of the horse racing industry.

The New York State Racing and Wagering Board (SRWB) regulates all horse racing activities in New York State. Accordingly, the Law gives the SRWB overall responsibility for regulating the State's OTB program and divides the State into seven geographical regions for OTB purposes. Each region consists of a participating county or a number of counties and, in some cases, certain cities. There are seven OTB regions in New York State, six of which — Capital, Catskill, Nassau, New York City, Suffolk, and Western — have established OTB corporations. The Central New York region has not formed an OTB corporation.

Revenues earned by the regional OTB corporations (OTBs or corporations), and the distributions of those revenues, are defined by applicable sections of the Law. These definitions include the following:

- Commissions on Handle - A certain percentage (commission) of the total amount of money wagered (the "handle") that is retained by the regional OTB corporation. The percentage varies, depending on the type of wager and the location of the race.
- Breakage - Revenues derived from the downward rounding of winning payout amounts.
- Surcharge and Surcharge Breakage - A surcharge of 5 percent imposed on winnings payable to individuals whose bets were placed at OTB facilities (other than Teletheaters and certain telephone accounts). Generally, 50 percent of such revenues is distributed to the governments where the racetracks are located; and the remaining 50 percent is distributed to the OTB's participating localities on a monthly basis. Half of the latter distribution is allocated according to the size of the local population, and the other half is based on the percentage of the handle wagered in that locality during that month.

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- Compensation to the Racing Industry - Commissions on handle paid to appropriate breeding funds, tracks, and racing associations.
 - Payments to New York State - Pari-mutuel taxes on handle paid to New York State. The specific rates depend on the location, the type of race, and the type of wager.
 - Surcharge for Capital Acquisitions - Effective July, 1990, the Law was amended to allow the OTBs to collect a 1-percent surcharge on certain wagers to finance the acquisition, construction, or equipping of offices, facilities, or premises of the corporation.
 - Net Revenue - The net amount remaining after the statutory and contractual payments and operating expenses, to be determined and distributed to participating localities on a quarterly basis. As in the case of surcharge and surcharge breakage, half of the allocation is based on the size of the local population, and the other half on the size of the handle.

SRWB reports show that for the 1997 calendar year, about \$1.835 billion in bets were made at the six regional OTB corporations, which also had about \$15 million in other revenues. About \$1.4 billion was paid to winning bettors. Of the remaining \$450 million, about \$80 million was paid to local governments, \$135 million was paid to State race tracks, \$14 million was paid to the breeders' funds, and \$20 million was paid to the State Treasury. The corporations had aggregate operating expenses of about \$200 million.

For the 1998 State fiscal year, the SRWB had a total State-appropriated operating budget of \$14.7 million and employed 123 staff. Twelve of these employees spend some or all of their time on activities related to overseeing OTB operations. SRWB officials estimated that their combined OTB oversight efforts are the equivalent of about 5.5 full-time employees. A majority of the other SRWB employees are inspectors, occupational licensing personnel, or monitors of games of chance.

Audit Scope, Objectives, and Methodology

We audited the SRWB's efforts to oversee the operations of the six regional OTB corporations for the period of January 1, 1995 through June 30, 1998. The objectives of our performance audit were to: (1) evaluate the adequacy of the SRWB's monitoring of OTB activities that were related primarily to generating revenue, and (2) evaluate the effectiveness

of guidance given by the SRWB to ensure that the boards of directors (boards) of the regional OTB corporations fulfill their responsibilities. To accomplish our objectives, we reviewed reports of prior Office of the State Comptroller (OSC) audits of the SRWB and the six OTB corporations, SRWB procedures and regulations, the corporations' board meeting minutes and financial reports, and SRWB's investigative reports of Capital OTB; interviewed responsible SRWB managers; and analyzed statistical and financial information related to the OTB program. In addition, in conjunction with the OSC's Division of Municipal Affairs, we reviewed selected activities of the boards of directors at the regional OTB corporations. As part of this audit, we provided preliminary audit findings to the regional OTB corporations that included recommendations for improving corporate governance, as appropriate.

We conducted our audit in accordance with generally accepted government auditing standards. Such standards require that we plan and perform our audit to adequately assess those operations of the SRWB which are included within the audit scope. Further, these standards require that we understand the SRWB's internal control structure and compliance with those laws, rules and regulations that are relevant to the operations which are included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments, and decisions made by management. We believe that our audit provides a reasonable basis for our findings, conclusions, and recommendations.

We use a risk-based approach to select activities for audit. We therefore focus our audit efforts on those activities we have identified through a preliminary survey as having the greatest probability for needing improvement. Consequently, by design, we use finite audit resources to identify where and how improvements can be made. We devote little audit effort to reviewing operations that may be relatively efficient or effective. As a result, we prepare our audit reports on an "exception basis." This report, therefore, highlights those areas needing improvement and does not address activities that may be functioning properly.

Response of SRWB Officials to Audit

A draft copy of this report was provided to SRWB officials for their review and comment. Their comments have been considered in preparing this report and are included as Appendix B.

Within 90 days after final release of this report, as required by Section 170 of the Executive Law, the Chairman of the New York State Racing and Wagering Board shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented, the reasons therefor.

Oversight of the Off-Track Betting Corporations

The State Legislature has given the SRWB ultimate supervisory and regulatory power over regional OTB corporations, to monitor whether they achieve their stated goal of generating a reasonable revenue for State and local governments. The Law gives SRWB general jurisdiction over the operation of all OTB facilities and the power to issue rules and regulations. It requires each regional OTB corporation to submit a plan of operation to the SRWB for approval, and it authorizes the SRWB to amend the plans if necessary. The State Legislature mandated that the SRWB prescribe a uniform accounting system for the regional OTB corporations and oversee the financial condition of each corporation by the receipt of daily accounting reports and monthly financial statements of each corporation. This clearly indicates that the SRWB is expected to monitor the financial condition of each regional OTB corporation. The SRWB also has the power to audit and investigate the regional OTB corporations and can enforce its authority over the regional OTB corporations by suspending their plan of operation for up to 20 days prior to a hearing, in effect ceasing their OTB activity for that period, and may indefinitely suspend the plan of operation if warranted after a hearing.

We concluded that the SRWB had provided very little monitoring and oversight for the regional OTB corporations until 1997, but has since increased its oversight activities with a new management team. We commend the SRWB for its increased efforts at monitoring and overseeing the regional OTB corporations and offer suggestions for further improving the SRWB's effectiveness in the area of monitoring off-track betting.

Financial Reporting

SRWB has prescribed a uniform chart of accounts for the regional OTB corporations. It also requires monthly and annual financial reports, including comparable accounts of the "simulcast" wagering revenue generated by bets on out-of-state horse races that are broadcast live on televisions at OTB facilities. These financial reports contain information that is potentially comparable among the regional OTB corporations. Although all of the corporations use a uniform chart of accounts, they do not all compile and report financial information consistently. As a result, it is difficult to make valid comparisons of their financial operations without first adjusting the data, which SRWB staff has had to do. We noted the following inconsistencies in financial reporting:

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- The audited financial statements of Capital OTB and Western OTB do not distinguish surcharge earnings from other revenues, although the Law allows the corporations to report in this manner.
 - The audited financial statements of Western OTB and Suffolk OTB do not detail branch or corporate expenses, while those of the Nassau and Catskill OTBs do not identify branch and corporate expenses. The New York City OTB's audited financial statements do not disclose totals of branch and corporate expenses.
 - New York City OTB's audited financial statements are prepared for fiscal years ending June 30, while the other regional OTB corporations use the calendar year.
 - The OTB corporations present the results of their operations in different formats in their audited financial statements.
 - The simulcast reports are supposed to contain comparable information, but the SRWB has had to adjust the reported data to make them comparable because the corporations do not all prepare the reports the same way.
 - All of the regional OTB corporations use different methods to account for and report the Capital Acquisition Fund, which is used to finance capital purchases and improvements and is derived from a supplemental 1-percent surcharge on various pari-mutuel wagering pools or from regular earnings, subject to specified limits. Capital OTB reports the surcharge as part of its gross revenue, and as a full disbursement; it neither reports a fund balance nor identifies the assets purchased with fund money. Each of the other corporations reports a fund balance on its audited balance sheets as a component of benefits undistributed to participants. However, each uses different methods of accounting for the assets and for adjusting revenues and expenses on the balance sheets. Western OTB also includes a component in its reported fund balance that represents the amounts it had withheld from its participants before the Capital Acquisition Fund legislation was enacted.

We suggest that the SRWB ensure that the audited financial statements of the regional OTB corporations present financial information in a standardized, consistent, and comparable format. This would improve public accountability for the corporations by allowing financial statement

users to readily compare and assess financial activity and the effectiveness of corporate policies and procedures. It is also important these reports contain sufficient detail, so that the information the users need is readily available. The SRWB should also promulgate financial reporting standards to be followed in the accounting and reporting of the revenues, acquisitions, and balances relating to the Capital Acquisition Fund surcharge. During our discussions with SRWB officials, they indicated that they would promulgate such standards.

Recommendations

1. Prescribe a standard format and reporting year for the annual financial reports.
2. Promulgate standards for the accounting and reporting of the Capital Acquisition Fund revenues, acquisitions, and balances.

Audits and Investigations

Although it had the authority, the SRWB did not routinely audit or investigate activities at the regional OTB corporations until late 1997. The SRWB had generally relied on the Office of the State Comptroller (OSC) to perform this function, but it did not effectively use OSC's audit reports to determine whether the corporations were being managed properly and achieving the desired results. Between 1995 and 1997, OSC's audit reports identified a number of problems at some regional OTB corporations that needed corrective action. Furthermore, the financial condition of Capital OTB declined to the extent that operating losses had been incurred in four consecutive years. As discussed later in this report, Capital OTB consistently had high expenses as a percentage of handle, while at the same time it had the lowest net revenues as a percentage of handle of all of the regional OTB corporations.

Capital OTB became the focus of continuing media coverage, based on allegations of mismanagement by the corporation president, who was also the chairman of its board. A lack of expenditure control at Capital OTB resulted in questionable practices in the areas of compensation packages for top staff, vehicle usage, travel and entertainment, and advertising and promotional expenses. For example, complimentary in-house food and entertainment expenses at the Capital OTB Teletheater in Albany totaled

more than \$750,000 during 1991-97. Between late 1997 and early 1998, after receiving complaints from a Capital OTB board member and an Albany County official, the SRWB began to take a more active monitoring role. At the end of 1997, the SRWB performed a two-month investigation of the allegations at Capital OTB and issued a report to Capital OTB in January 1998 that included 27 findings. The SRWB concluded that Capital OTB could have increased net revenues by \$4 million during the seven-year period ended December 31, 1997 if certain questionable operating practices had not occurred. SRWB officials required Capital OTB to develop a corrective-action plan for responding to the 27 findings; and stated that they would continue to monitor the progress of its implementation.

The problems at Capital OTB were longstanding and the SRWB had been aware of some of the issues that were reported in previous OSC audits. Although these problems might have been limited if the SRWB provided better oversight and monitoring in the past, we are encouraged by SRWB's new direction and priorities and suggest that it continue to identify issues that need to be audited and investigated at the regional OTB corporations. SRWB has recently initiated a review of operations at Catskill OTB.

The Law gives the SRWB the authority to ensure that the regional OTB corporations implement the audit recommendations resulting from an audit or investigation. Although the corporations are routinely audited by OSC, the SRWB had not utilized these audits as a meaningful monitoring tool until early in 1998, because the SRWB had not followed up to ensure that the corporations implemented the auditors' recommendations. Because of the recent findings at Capital OTB, the SRWB has taken a greater interest in OSC's audit recommendations and their implementation. For example, OSC noted that the net revenues Capital OTB was distributing to participating governments had decreased significantly for several years, while the corporation had continued to make expenditures for certain items with unclear benefits (e.g., annual tennis tournaments, golf tournament prizes, etc.). The SRWB included these observations in its report on Capital OTB, and required the corporation to prepare and implement an action plan that would correct the problems. Meanwhile, the SRWB began to utilize prior OSC audit reports to identify similar risks at the other regional OTB corporations. During our audit, SRWB officials also suggested ways that they and OSC could cooperate in the future to improve oversight of the OTB operations. We encourage the SRWB to continue using our audit reports as a monitoring tool and suggesting that

the regional OTB corporations implement the improvement opportunities the reports present.

Recommendations

3. Continue to periodically audit and investigate the regional OTB corporations.
4. Use external audits, including those performed by the Office of State Comptroller, to help monitor the activities of the regional OTB corporations; and require the corporations to implement the recommendations generated by those audits.

Monitoring OTB Operations

The SRWB is responsible for monitoring the regional OTB corporations' operations, and should require corrective action when it is deemed appropriate. We have identified the following standards as primary concerns in SRWB's oversight of the corporations:

- compliance with governing statutes and SRWB rules,
- involvement of the corporation's board of directors in oversight and management, and
- recognition by both the board of directors and corporate management that the statutory purpose of an off-track betting corporation is to generate revenues for local government, the State of New York, and the racing industry; and the commitment to operating the corporation in a manner that is consistent with this purpose.

To improve accountability, the SRWB should develop performance indicators for evaluating the corporations' performance in meeting the above standards. A performance indicator is a particular value or characteristic that measures outputs or outcomes that indicate progress toward a program's goals and objectives. For example, one performance standard requires involved oversight on the part of the OTB corporation's board of directors. When we reviewed the minutes of meetings held by the Catskill OTB board of directors during January through May of 1998, we noted that the Catskill OTB board had met just once during the

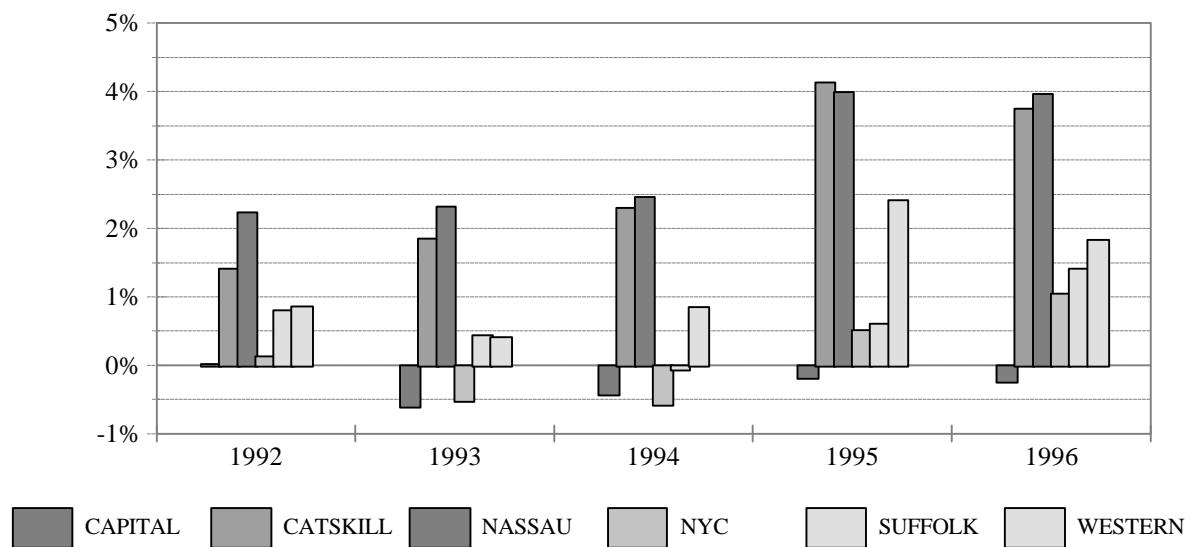
five-month period. Because the current standard is vague, it is unclear whether the Catskill OTB board of directors is providing involved oversight with such infrequent meetings. The SRWB should consider the development of performance indicators to evaluate oversight involvement by the corporations' boards of directors.

Another standard requires the regional OTB corporations to generate revenues for State and local government. We suggest that the SRWB define reasonable revenue, for example, in terms of percentage of handle, net income, or any other quantifiable means that will make it possible to evaluate the corporations' performance.

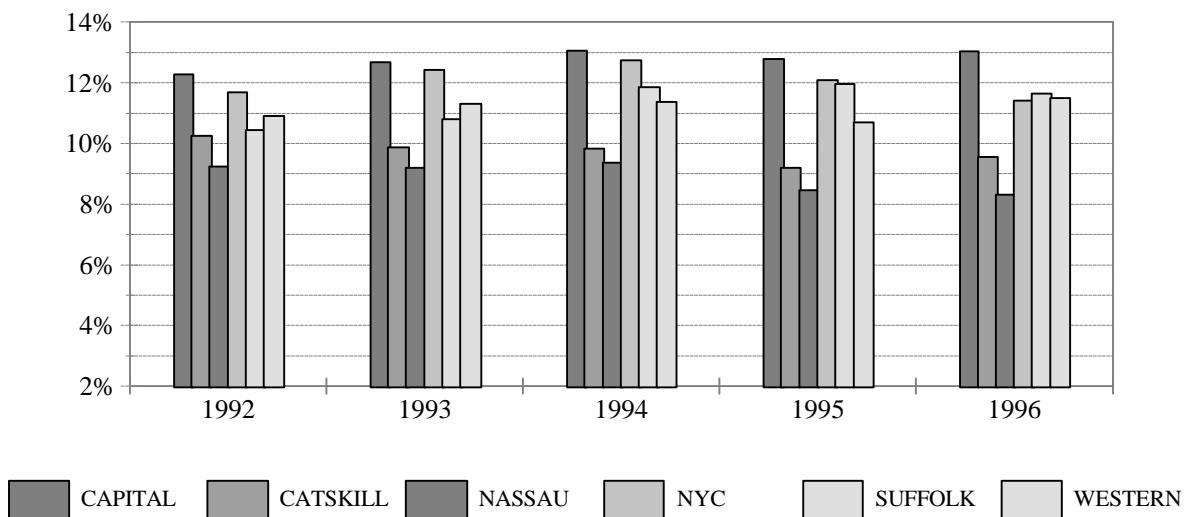
Performance measurement and reporting could make both management and the public aware of the corporations' actual performance, as well as the improvements that should be made. In addition, once performance indicators are developed, the corporations considered successful could share techniques with the less successful ones.

As examples of performance indicators, we have summarized information from the SRWB's simulcast reports, adjusting the data to make them comparable and highlighting important operating trends and differences among the regional OTB corporations, noting the following:

**TOTAL NET REVENUE
AS A PERCENTAGE OF HANDLE**



TOTAL OPERATING EXPENSES AS A PERCENTAGE OF HANDLE



As the preceding graphs show, Capital OTB and, to some extent, New York City OTB have not performed as well as other corporations in terms of the percentage of the total net revenue and operating expenses as a percentage of the betting handle. The graphs also show that, in contrast to improvements in the New York City OTB's recent performance, the results at Capital OTB continue to be the worst in the group.

In early 1998, the SRWB developed an Examination Program for Monthly Regional OTB Financial Statements (monthly examination) and an Annual Desk Review of Financial Statements (annual review). The monthly examination is intended to be a general fiscal review that ensures timely reporting and the accuracy of data while the annual review is more in-depth. In the latter, the financial standing of the regional OTB corporation is evaluated in a number of ways, including a determination of the ratio of current assets to current liabilities, an evaluation of profitability, and a review of comparative and trend analyses. Where the SRWB identifies negative trends, it asks the corporation to develop corrective action plans, explain whether it funds operations from financing or investing activities, and identify whether the pension and deferred compensation plans are funded or underfunded. In addition, the annual review requires a detailed listing and review of OTB expenditures, identification of related party transactions, and a judgement to be made on

the independence of the CPA firm that audited the financial statements. The SRWB has recently completed its annual review of all six regional OTB corporations for calendar 1997. These monthly and annual reviews should help the SRWB identify negative trends and prevent continuous years of problems such as those found at Capital OTB. We encourage SRWB to continue using both the monthly and annual reviews and to follow up on the negative trends they reveal.

As noted above, during the annual review process the SRWB recently developed, SRWB reviews the independence of certified public accounting firms hired by the OTB corporations to perform their annual financial statement audits and the internal audit staff that some of the corporations use. The Legislature has given the SRWB authorization to approve the selection of the certified public accounting firm hired by the New York Racing Association, Inc. We believe SRWB should consider seeking similar legislation regarding the OTB corporations. It could also improve its annual review by reviewing the charter of any internal audit unit, to better understand the internal auditor's role. In addition, SRWB should monitor the implementation of any recommendations made by OSC and the certified public accounting firms regarding the corporations' internal audit functions.

Not all regional OTB corporations adopt formal budgets. We believe the SRWB should have each regional OTB corporation submit a budget or financial forecast at the beginning of each year. This management tool would enable the SRWB to track planned performance, and would help prevent the development of budgets with a planned net loss. Periodically and at year end, the SRWB should compare the budget or forecast to actual spending, identify negative variances, and request justifications from regional OTB corporation officials. Timely corrective actions can be initiated to avoid reoccurrence of the same problems.

As an oversight agency, SRWB should become actively involved with the corporations (e.g., by attending selected board meetings and reviewing the minutes from all such meetings). Familiarity with the boards' policy-making activities would provide SRWB with firsthand knowledge of important decisions and an opportunity to evaluate the effectiveness of each board's monitoring efforts. As shown in the following table, we found that an SRWB official had attended just 4 percent of all of the meetings held by the OTB boards of directors in 1997, a significant drop from the 1995 attendance rate of 57 percent. We also noted that the SRWB was not represented at any of the Nassau OTB board of directors meetings held between January 1, 1995 and December 31, 1997.

Summary of SRWB Attendance at Regional OTB Corporation Board Meetings Calendar Years 1995 through 1997												
OTB Region	1995			1996			1997			Total		
	Held	Attnd	%	Held	Attnd	%	Held	Attnd	%	Held	Attnd	%
Capital	11	9	82%	9	4	44%	6	1	17%	26	14	54%
Catskill	3	2	67%	4	1	25%	4	0	0%	11	3	27%
Nassau	9	0	0%	6	0	0%	10	0	0%	25	0	0%
NY City	10	8	80%	8	8	100%	7	1	14%	25	17	68%
Suffolk	11	4	36%	12	4	33%	11	0	0%	34	8	24%
Western	12	9	75%	12	0	0%	11	0	0%	35	9	26%
Total	56	32	57%	51	17	33%	49	2	4%	156	51	33%

During the five-month period of January through May of 1998, the SRWB increased its presence at these meetings; attending 45 percent of the meetings. The SRWB also obtains copies of the minutes of each OTB board meeting. We encourage a continued increase in SRWB attendance at such meetings, as well as reviews of minutes of the meetings.

In 1988, OSC performed an audit with objectives similar to the ones stated for this audit (Report 88-S-81: *Oversight of Off-Track Betting Operations*), and found that, overall, the SRWB needed to improve its monitoring efforts over the regional OTB corporations. SRWB officials responded that they did not have the authority to monitor in the way our previous report had recommended. During 1995 and 1998, the SRWB proposed changes in the Law that would have enhanced its ability to oversee the corporations and improve their business practices. These legislative proposals, in brief, requested authority to: impose fines on a corporation for violating the Law; direct the corporations to cause their business and managerial practices to be audited at their own expense; prohibit the corporations from donating monies or services to organizations with which any officer or director has a direct connection; and require the corporations to establish internal control procedures. As of our audit, these proposals have not been enacted by the Legislature.

Although the proposed legislation might give the SRWB more specific enforcement powers, the existing Law already allows the SRWB to monitor operations at the regional OTB corporations in the manner we suggested in our prior audit. The recent actions the SRWB has taken to

oversee and monitor the corporations' operations suggest that the SRWB could take a more active role. We commend the recent monitoring improvements the SRWB has made, and recommend that it continue to expand and develop its monitoring techniques to better assure the public that the regional OTB corporations are performing in their best interests.

Recommendations

5. Continue the development of a performance measurement system, including specific performance indicators to better monitor corporate activities.
6. Continue to review the regional OTB corporations' monthly and annual financial reports, analyzing the financial and other operating data and identifying legitimate variances, important trends, and areas that need improvement.
7. Consider proposing legislation similar to what exists for NYRA, to give the SRWB responsibility for approving the selection of certified public accounting firms to perform annual audits at each of the corporations.
8. Review the charters of the internal audit functions for those regional OTB corporations that have established such a function to better understand the internal auditors' role; and monitor the implementation of any recommendations made by OSC and the certified public accounting firms regarding the OTB corporations' internal audit functions.
9. Ask regional OTB corporations to submit annual budgets or forecasts, and follow up on negative variances.
10. Continue to increase SRWB attendance at meetings of the regional OTB corporations' boards of directors, as needed.

Corporate Governance

Each regional OTB corporation's board of directors has primary management responsibility for its respective operations. Section 502 of the Law states that the powers of each corporation shall be vested in and exercised by its board of directors. The Law also defines the number of members each board should include and explains how the board members are to be appointed. Generally, participating governments are responsible for appointing directors to the boards.

The SRWB relies on these boards to ensure that the corporations' operations are consistent with the intent of the Law. In light of recent problems at Capital OTB, it is clear that its board did not oversee and control its operations in a prudent manner. After a thorough investigation of Capital OTB, the SRWB held its board responsible for the problems, concluding that the board's inability to control expenditures was due primarily to a lack of oversight.

Internal controls are made up of a system of processes designed to provide reasonable assurance that certain objectives — such as the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations — will be achieved. The board of directors is ultimately responsible for ensuring that an adequate system of internal controls is established and is working properly. In addition, it is important that the board of directors sets a positive tone, influencing the control consciousness of its management, so that all employees understand the importance of complying with its directives and achieving corporate objectives.

We found that the boards of directors of the various regional OTB corporations have functioned in a wide variety of ways; some boards, such as the boards of the New York City and Western OTB corporations, have been more effective than others. We believe that some of the less-effective practices limit the boards' ability to ensure that corporate objectives, including the generation of a reasonable revenue for local and State governments, are being achieved. We conclude that the SRWB should work with the appointing authorities (i.e., local governments) and the boards to ensure that the board members understand their responsibilities, obtain necessary training or outside assistance, and implement the types of improvement opportunities that we have identified and the SRWB may identify in the future.

The following section of this report presents corporate governance problems we found at the six regional OTB corporations.

Attendance at Board Meetings

An active and involved board of directors can ensure that a corporation is managed in an efficient and effective manner. The Law recognizes this to a certain extent in Section 502, which states that, for the mutual good of the corporation, a majority of a board's members must be present to constitute a quorum at its meetings.

The Catskill OTB board of directors consists of nine individuals who are appointed by their respective counties to set sound corporate policies and ensure that the corporation is run effectively according to those policies. The board meets quarterly, with a quorum of at least five members required at each meeting. However, we noted that during both 1996 and 1997, the required quorum was not achieved at a single meeting; at most, four of the nine Directors attended. Two of the nine Directors did not attend any meetings at all during either year. Thus one can question whether the Catskill OTB had any official board meetings during that period. We consider this to be a significant corporate governance problem. The following table shows attendance data at the eight regular board meetings held during 1996 and 1997, for a judgmental sample of five directors:

Board Member	Number of Meetings Attended in 1996	Number of Meetings Attended in 1997	Total Number of Meetings Attended	Total Number of Meetings Held	Percentage of Meetings Attended
Chairman	1	1	2	8	25 %
B	3	3	6	8	75 %
C	2	3	5	8	63 %
D	0	0	0	8	0 %
E	0	0	0	8	0 %
Total	6	7	13	40	33 %

Note: The sample included the board chairman, two directors who had attended board meetings frequently, and two directors who did not attend any meetings.

We conclude that the Catskill OTB directors who do not regularly attend board meetings should consider resigning from the board or the constituent

counties should consider replacing these directors. Increased representation at board meetings should improve its public accountability, and should improve the quality of the group's decision-making, as well, because more diversified information would be coming from board members with different areas of expertise, experience, and insights. Broader-based decisions should also help ensure that the corporation is managed efficiently and effectively, and should strengthen the control environment.

We found that successful corporations are increasingly likely to supplement the activities of their board members by establishing a corporate governance committee, whose functions include recommending appointments to the board, examining and revising other board structures and committees, and improving board member participation and involvement in corporate policy-making, decision-making, and oversight. We believe the SRWB should work with the OTB boards to ensure that directors understand the obligation they accept when they agree to serve. The corporate governance committee is a best practice which the SRWB may wish to consider promoting.

Section 502 also states that the Nassau OTB board of directors shall consist of three members, with no more than two belonging to the same political party. However, based on our review of the minutes of meetings held by the Nassau OTB board during 1996 and 1997, we found that just two directors have attended the meetings. We understand that the third board position remained unfilled during the two-year period covered by our audit. Because boards can benefit from the synergy that results when diversified individuals with different experience, expertise, and opinions have the opportunity to contribute to the decision-making, we believe the SRWB should encourage the appointing authority of the Nassau OTB to fill its vacant board seat with a qualified individual.

Performance Guidelines for Corporate Officers

Another trend in corporate governance is to have the board of directors establish comprehensive performance guidelines for corporate officers. Such guidelines generally deal with measurable expectations, such as the ability to generate a profit, satisfy customers, or maintain an acceptable employee turnover rate. These boards also meet periodically with corporate officers to discuss their achievements in terms of the established performance guidelines.

We found that while New York City, Suffolk, and Western OTBs have established performance guidelines for their corporate officers, Catskill and Nassau OTBs have not established such guidelines. Also, although

the Capital OTB board of directors has established performance guidelines for corporate officers that are related to the preparation of forecasted financial statements, the guidelines are limited. In addition, the boards of directors of these three regional OTB corporations have not held periodic meetings with their corporate officers to discuss the officers' achievements and performance. We believe the Capital, Nassau, and Catskill OTBs' boards of directors could strengthen their processes by establishing comprehensive, written performance guidelines for their corporate officers, which include items such as the ability to: generate a profit or increase profit from one period to another; increase the OTB betting parlor attendance; increase the monetary value or number of bets placed; maintain acceptable working conditions and an acceptable employee turnover rate; and discourage unlawful bookmaking and illegal wagering. Establishing guidelines will help provide the boards of directors with reasonable assurance that their officers are performing at levels that achieve corporate goals. The SRWB should, in time, work with the boards of directors to help them implement performance guidelines for corporate officers.

Accountability for Operating Results

A corporation's business cycle includes planning, conducting, summarizing, and evaluating operations. Good controls over the business cycle include performing assessments, comparisons, and analyses of operations. For example, comparing actual performance to budgets or forecasts may identify variances, both positive and negative. Once variances are identified, the causes and their associated justifications can be pursued and corrective action, if necessary, can be taken. For example, the board of directors can investigate the causes and justifications for shortfalls in revenue or unexpected increases in expenses. Depending on the justifications and causes, the board may require timely corrective actions to ensure that negative performance is not repeated.

We found that while New York City, Capital and Western OTBs prepare formal annual budgets, Catskill, Nassau, and Suffolk OTBs don't. At Capital OTB, financial information such as monthly financial statements that contain historical financial data are presented at board meetings, but the board does not use this or other data to perform multi-year trend analyses or make comparisons of annual budgets against actual operating results. We believe the boards of directors could improve their oversight of operations by requiring annual budgets, performing multi-year trend analyses, comparing actual operating results to budgets, identifying negative trends, and taking timely corrective actions. The SRWB should work with the boards to ensure that this process is implemented.

Board Involvement with Policies and Procedures

Boards of directors influence corporate controls by approving and adopting policies and procedures. These policies and procedures should be reviewed periodically for adequacy and amended as necessary. Corporate officers are expected to carry out board policies using board-authorized procedures to accomplish corporate goals and objectives.

During our audit, we learned that some of the policies and procedures in Capital OTB's Operations Manual have not been authorized by its board of directors; rather, they have been added by the president of the corporation. We also found that the Capital OTB board does not periodically review corporate policies and procedures for adequacy, or amend the policies and procedures as necessary. In addition, until the fall of 1997, it did not monitor operations for compliance with the established policies and procedures. These conditions lead us to conclude that the Capital OTB's board of directors has delegated much responsibility to the corporate president without developing associated oversight of his area of responsibility.

We recognize and commend the Capital OTB board for its 1997 move to begin monitoring for compliance with the official policies and procedures it had established to conform with its corporate goals and statutory requirements. Such monitoring can assure the board in the future that its policies and procedures are adequate and that they are being followed.

The Catskill OTB board of directors has also delegated broad powers and duties to its corporation president. However, it has not overseen matters such as purchasing, setting employee compensation, and financial forecasting, and has not actively monitored the staff for compliance with established policies and procedures. Board minutes also indicate that very little corporate business is conducted at these meetings relating to internal control issues and policy matters. The board needs to routinely or periodically review its corporate policies and procedures for adequacy, and amend them as necessary.

The Suffolk OTB and Nassau OTB boards of directors also do not conduct periodic reviews of corporate policies and procedures for adequacy, or amend their policies and procedures as necessary. Nor do these boards monitor for compliance with established policies and procedures. Furthermore, we found that the Nassau and Suffolk boards do not require their approval if corporate business passes a certain monetary threshold.

We believe the SRWB should encourage the OTB boards of directors to improve their control by taking a more active role in overseeing and participating in matters related to corporate policies and procedures.

Internal Audits

Section 2932 of the Public Authorities Law requires governing boards of public benefit corporations to determine whether the corporation needs an internal audit function. If they decide there is such a need, the boards must establish an internal audit entity that will operate in accordance with generally accepted professional standards for internal auditing. The Public Authorities Law also requires the boards to ensure that the internal auditor reports directly to the board, and evaluates internal controls and operations, identifies internal control weaknesses, and makes recommendations for correcting those weaknesses.

According to the Institute of Internal Auditors, a formal, written charter should be established for an internal audit department for several reasons: to clearly define the department's authority, to outline the scope of its activities, and to provide a basis for evaluating the overall effectiveness of its auditing capability.

Contrary to Section 2932 of the Public Authorities Law, the internal audit departments of Nassau, Suffolk, Capital and Catskill OTBs do not report directly to their respective boards of directors, while the internal audit departments of the New York City and Western OTBs do. In addition, we found deficiencies in the scope and authority of the work performed by the Capital OTB's internal audit department. For example, it lacks the authority to examine and evaluate activities critical to the corporation, particularly the payroll and marketing departments that were responsible for about 47 percent of all of the corporation's operating expenses during 1997. Nor does it examine or evaluate internal controls or test corporate-level cash receipts. We also found reason to question the effectiveness of the internal audit department's work. For instance, it did not investigate physical inventory discrepancies; it merely adjusted the inventory records to agree with the assets on hand.

The directors of the Capital OTB board can ensure the independence of their internal audit department and improve their understanding of internal audit matters by having the internal auditor report directly to them. They should provide the department with a formal charter that sets forth the scope and authority of its activity. We suggest that SRWB evaluate the internal audit function at all of the regional OTB corporations. The

internal auditors should report directly to their respective boards of directors.

External Audits

Section 517 of the Law requires the regional OTB corporations' boards of directors to obtain annual audits of their operations. Such independent evaluations are to provide the boards of directors with valuable feedback by determining the fairness of the corporation's accounting records, and by identifying areas where improvement is possible.

As a trend in corporate governance, boards periodically change their auditing firms or otherwise solicit proposals for auditing services (e.g., at two- to five-year intervals). By such periodic solicitations, boards can have the opportunity to re-evaluate the cost of services as well as other relevant factors, such as experience and staffing of the audit team. Therefore, the practice of soliciting proposals may also result in reduced costs and improved services through increased competition. Organizations may also benefit from a fresh look at operations by different professionals.

Both the Catskill OTB and the Suffolk OTB have not sought to change their auditing firms for many years. We believe that both of these boards of directors should periodically solicit competitive proposals for their audit services, to help ensure that they obtain the highest-quality services at the best price. These steps can help improve the control environment at the Catskill OTB and the Suffolk OTB, and will assist these boards of directors by providing them with reasonable assurance that the corporations' goals are being achieved. The SRWB should encourage each regional OTB corporation to periodically solicit competitive proposals for auditing services.

Recommendation

11. Provide guidance to the board of directors at each regional OTB corporation and ensure that board members understand their responsibilities, with specific emphasis on the following:
 - Attending board meetings and taking an active role in the decision-making process of their respective OTB.
 - Encouraging the appointing authorities to replace inactive board members and to fill vacant board positions.

Recommendation (Cont'd)

- Establishing a comprehensive set of performance guidelines for corporate officers.
- Meeting periodically with corporate officers to review their performance in regard to expectations.
- Requiring the preparation of annual budgets and comparing actual operating results to anticipated and past results, identifying variances and taking appropriate corrective actions.
- Strengthening involvement in the approval and adoption of all official corporate policies and procedures, and in the periodic review and amendment of policies and procedures.
- Ensuring that a formal, written internal audit charter is prepared for internal audit departments. Among other important attributes, this charter should include provisions to: ensure that the internal audit department reports directly to the board of directors; define the authority of the internal audit department; outline the scope of internal auditing activities; and provide a basis for evaluating overall audit effectiveness.
- Conducting periodic solicitations for proposals to provide independent auditing services, to ensure that the best services are being obtained at a reasonable price.

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**STATE OF NEW YORK
RACING AND WAGERING BOARD**

March 1, 1999

Mr. Frank J. Houston
Audit Director
Office of the State Comptroller
Division of Management Audit &
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270 Broadway, 19th floor
New York, New York 10007

Dear Mr. Houston:

Enclosed is the response to the New York State Comptroller's draft audit report regarding the New York State Racing and Wagering Board's oversight of OTB Corporations. Staff of the State Racing and Wagering Board is available to answer any questions you may have after you have reviewed this response.

The Board appreciates the Comptroller's cooperation and courtesy in this matter and we look forward to finalizing this audit.

Very Truly Yours,

A handwritten signature in black ink, appearing to read "Michael J. Hoblock".

Michael J. Hoblock
Chairman,
New York State Racing and Wagering Board

Enc.

CC: Roger Mazula, OSC

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**Response to The Office of the State Comptroller's
Draft Audit Report on
New York State Racing and Wagering Board's
Oversight of Regional Off-Track Betting Corporations**

Report Overview

As a regulatory agency, the State Racing and Wagering Board (SRWB) appreciates constructive suggestions of agency operations and performance. The items outlined in the first section of the draft audit report (98-S-13) titled New York State Racing & Wagering Board Oversight of Regional Off-Track Betting Operations, acknowledges the direction that this agency has taken under the new administration. In fact most of the recommendations outlined in this report have or are in the process of being implemented.

SRWB staff appreciates the professional courtesies and consideration showed to them by the OSC auditors who worked on this report. We find ourselves in much the same position as staff at the Office of the State Comptroller in that both jobs require constant review of operations of various organizations in an attempt to determine if they are meeting their stated objectives.

The second section of this report titled, Corporate Governance, mainly deals with items / deficiencies noted at various Regional OTB Corporations and not the SRWB. While some of the comments in this section effect the SRWB in some ways, most of the observations and recommendations, if not all of them, require correction by the Regional OTB Corporations.

This brings us to a premise in which we have some disagreement with the OSC. We believe that the local participating municipalities bear at least some of the responsibility because they appoint members to the board of their Regional OTB Corporation. Because of this basic difference in interpretation of law we believe each Regional OTB board should address some of the items listed in this report.

Financial Reporting

While staff of the SRWB agree, and in fact have already addressed the recommendations made in this section of the report (as noted below) we would also like to point out some comments that need clarification.

OSC states "that it is difficult for the SRWB to make valid comparisons of their (Regional OTB Corporations) financial operations". Staff of the SRWB provided copies to OSC auditors of comparative financial statements that SRWB staff prepared where each Regional OTB Corporation was presented in the same format. Various financial ratios were applied to these schedules by SRWB staff and compared to each OTB Corporation. In addition staff performed a five year trend analysis for each OTB

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Note
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Corporation. Therefore staff believes this comment is somewhat misleading as valid comparisons have been made and copies of these comparisons have been provided to OSC.

Staff would also like to take this opportunity to state that the Regional OTB Corporations have historically been reporting to the SRWB in much the same format for years. It is from these reports that OSC has made their observations and recommendations.

Recommendation #1 – Standardized Reporting:

SRWB staff developed standard financial reports to be used in the Regional OTB Corporation annual financial statements that are to be implemented. Staff developed these standard financial reports after input from each of the Regional OTB Corporations as well as OSC staff. Therefore this recommendation is in the process of being implemented. However all of the Regional OTB Corporations have objected to standardized reporting therefore staff is continuing to pursue this objective.

Recommendation #2 Capital Acquisition Fund:

SRWB staff is in the process of promulgating standards for the accounting and reporting of the Capital Acquisition Fund. We will seek comment and input from both the Regional OTB Corporations and OSC staff. Staff will then issue a final notification of the new standards after all of the affected parties have had an opportunity to comment and make recommendations.

Audits and Investigations

Under the leadership of Chairman Michael Hoblock, the SRWB has led and will continue to lead a proactive role in monitoring the Regional OTB Corporations. Since OSC is the agency required by statute to annually audit the Regional OTB Corporations, the SRWB will continue to study OSC's audit reports and monitor the OTB's response to the issues raised.

SRWB staff looks forward to cooperating with OSC in an effort to continue to coordinate our oversight responsibilities.

Recommendation #3 Periodic Audits and Investigations:

Periodic audits and investigations will continue to be performed by SRWB. We appreciate OSC's recognition of our increased efforts in this area under Chairman Hoblock's leadership.

Recommendation #4 Use of External Audits :

SRWB staff will continue to review external audits, including those performed by OSC, and will monitor how issues raised in those reports are addressed.

Recommendation #9 Annual Budgets:

It should be noted that current legislation does not require each Regional OTB Corporation to adopt a formal budget therefore the SRWB cannot require such a submission from all of the OTB's. Staff currently receives and reviews the annual adopted budgets of those Regional OTB Corporations that prepare formal budgets. SRWB staff does compare the actual results to the budgeted, or planned results, and follows up on variances. Staff will continue to request that each OTB prepare and submit a formal budget.

Recommendation #10 SRWB Attendance at Regional OTB Board Meetings:

Under the guidance of Chairman Hoblock, SRWB staff have made considerable efforts to attend as many Regional OTB Board meetings as possible. In those instances where staff cannot attend a meeting, minutes of those meetings are obtained and reviewed. Staff will continue its efforts in this area.

Corporate Governance**Recommendation #11 Provide Guidance to the Board Members of the Regional OTB Corporations:**

This section of the report deals with items / deficiencies noted by OSC at some of the Regional OTB Corporations and not at the SRWB. OSC deals with these issues by concluding that the SRWB should address these deficiencies by providing guidance to the board members of each of the Regional OTB Corporations.

Current procedures include that before a board member is approved SRWB counsel personally contacts the appointee and reviews their responsibilities and obligations. Staff monitors the activity of each Regional OTB Corporation's Board by attending board meetings and reviewing board and committee minutes.

The SRWB will continue to review the various aspects of Corporate Governance and take appropriate actions.

Conclusion:

In summary, the State Racing and Wagering Board concurs with many of the recommendations of the Office of the State Comptroller. In fact the SRWB has already instituted, or is in the process of instituting many of the recommendations.

The SRWB and OSC agree that a working and cooperative relationship would benefit the industry and provide better management and more efficient operations. The SRWB review of operations along with OSC's audits will provide a balanced review of the financial condition of the OTB's. These findings and recommendations will improve the OTB's performance and benefit the participating counties.

The role of the local appointing authority i.e., participating counties legislature, is significant because they are responsible for the recruitment and appointment of a director. Therefore, any issues relating to the performance of a particular director should be brought to the attention of the participating counties.

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